

EVERCORE ISI

Energy | Power & Utilities

February 27, 2020

Essential Utilities Inc.

WTRG | \$46.96

In Line | TARGET PRICE: \$37.00

Company Update

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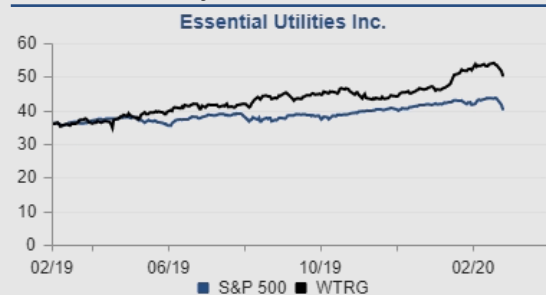
Company Statistics

Market Capitalization (M)	\$9,559
Shares Outstanding (M)	216
Dividend	0.91
Dividend Yield	2.0%
Payout Ratio	61.2%
Expected Total Return	(14.4)%
Fiscal Year End	Dec

Earnings Summary

	2019E	2020E	2021E
EPS	\$1.48	\$1.56	\$1.64
P/E	29.9	28.3	27.0
EPS vs Consensus	1.9%	(1.8)%	(2.4)%
Consensus EPS	\$1.45	\$1.59	\$1.68
Consensus P/E	30.5	27.8	26.4

1 Year Price History



LT Growth Outlook Below Expectations

WTRG lagged peers today (-8% vs water uts/UTY -6%/-5%) amid a broad market sell off on a weaker than expected LT EPS growth outlook. The company initiated 2020 EPS guidance range of \$1.53 - \$1.58 and projects earnings to grow in the range of 5-7% on average from 2019 through 2022. Starting with 2019 adjusted EPS of \$1.47, 6% EPS growth rate mid-pt would translate into 2021 EPS of \$1.65 (includes ~10c repair tax uplift) materially below our bull case scenario of \$1.78 which assumes repair election + Delcora accretion, see our last note [here](#). Peoples Gas acquisition is expected to close in March 2020, combined water and gas, Essential expects to invest \$2.8B from 2019 through 2022. The abovementioned capex investment (including ~\$25MM towards reducing PFOS/PFOA levels) is projected to generate rate base growth of 6-7% in the water business and 8-10% in gas through the forecast period. We will be back with a model update and our '22 EPS projection, see additional details within.

2020 Guidance & LT EPS Growth. As we stated earlier, Essential initiated 2020 EPS guidance range of \$1.53-\$1.58 and projects EPS to grow in the range of 5-7% on average from 2019 through 2022. Both the guidance and LT earnings growth rate include 8-12c/year EPS uplift from repair tax flow through at Peoples gas. \$2.8B in planned investments through 2022 is driving projected 6-7%/8-10% rate base growth at water/gas during that period. Included in the capex plan is \$25MM in investment towards reducing PFOS/PFOA (potentially harmful chemicals in the water stream) levels to 13 parts per trillion across their service territory significantly below federal governments health advisory level of 70 parts per trillion. The company pointed to lower future earned ROE's (2019 returns were higher due to repairs flow through in the water business), regulatory lag on municipal acquisitions, and dilution from additional equity units as primary drivers of the lower expected EPS CAGR versus rate base growth.

Repairs Tax Election Uplift, 8-12c/yr. Essential's 2020 and forward looking EPS guidance includes 8-12c/share annual earnings uplift which is more/less in line with our estimate of ~10c. There may be additional accretion from historical balances pending commission review and final decision. For context, in 2012, Aqua (water utility) changed its tax method of accounting for qualifying utility asset repairs in PA. The tax accounting method was changed to permit the expensing of certain utility asset repairs/maintenance costs that were previously being capitalized and depreciated for tax purposes. The company used flow-through accounting for the tax benefits of the repair tax accounting change per the Pennsylvania rate order from June '12. The flow-through accounting implementation resulted in a reduction in the company's effective income tax rate, which in turn lowered income tax expense and increased net income. WTR's effective tax rate was materially lower than the statutory tax rate at (7.7%) / 6.6% / 8.2% for the years '18 / '17 / '16 respectively. Higher earnings power supported higher returns on equity, which allowed Aqua to invest over \$2bn of capital on system improvements over the past seven years without having to go in for rate cases in PA.

DELCORA Acquisition. In September '19, management had announced a signed purchase agreement with Delaware County Regional Water Authority (DELCORA), following DELCORA signing of a letter of intent with Aqua committing to exclusive discussions in August '19. DELCORA is a wastewater conveyance and treatment authority that serves approximately 500,000 people in 42 municipalities in Delaware and Chester Counties in southeastern Pennsylvania. We estimate that this could be a potential ~\$300mm rate base / \$0.03 EPS uplift in '21 (company expects to close in late '20/early '21), assuming 50%/50% debt/equity financing.

Peoples Gas Update. In March 2019, Essential received regulatory approval for the Peoples transaction from the Kentucky Public Service Commission, followed by approval in Kentucky next month. On 10/28/19 the PA Administrative Law Judge assigned to the case issued a proposed decision approving the Peoples Gas acquisition which was subsequently approved by the Commission in January this year. The company expects to complete the acquisition in March 2020.

2019 EPS. Essential reported FY 2019 adjusted EPS of \$1.47 which was more/less in line with our forecast of \$1.48. Compare to prior year EPS was \$ 0.06 or 4.3% higher driven by rate/surcharges supporting capex +\$0.16, customer growth +\$0.03, higher expenses -\$0.06, and lower usage/other -\$0.07.

VALUATION METHODOLOGY

Our \$37 target price is based on a SOTP where we assign 23.0x P/E to the earnings contribution from the legacy water business and ~21.0x to earnings from the gas segment. The 23.0x water P/E is in line with our water regulated peer average target multiple. The gas multiple of ~21.0x is also in line with current gas LDC trading valuation multiples.

RISKS

Risks to our thesis include an unfavorable regulatory outcome leading to lower rate base growth and/or lower allowed or earned ROEs in ongoing and future rate cases. Other risks include exposure to unusual weather, impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer, cyber security and water contamination.

COMPANIES UNDER COVERAGE BY AUTHOR

Symbol	Company	Rating	Price (2020-27-02)	Evercore ISI Target
AWK	American Water Works Company, Inc.	Outperform	\$128.81	\$118.00
AWR	American States Water Company	Underperform	\$82.80	\$60.00
CWT	California Water Service Group	In Line	\$50.69	\$46.00
DCP	DCP Midstream, LP	In Line	\$15.52	\$29.00
ENB	Enbridge Inc.	In Line	\$37.89	\$48.00
EPD	Enterprise Products Partners LP	Outperform	\$23.00	\$32.00
ET	Energy Transfer Partners, L.P.	Outperform	\$10.78	\$18.00
KMI	Kinder Morgan, Inc.	Outperform	\$19.62	\$22.00
MMP	Magellan Midstream Partners, L.P.	Outperform	\$55.47	\$67.00
MPLX	MPLX LP	In Line	\$19.15	\$34.00
OKE	ONEOK Inc.	In Line	\$67.78	\$65.00
PAA	Plains All American Pipeline, L.P.	In Line	\$13.69	\$20.00
PAGP	Plains GP Holdings, L.P.	In Line	\$13.83	\$25.00
SJW	SJW Group	In Line	\$65.23	\$65.00
TRGP	Targa Resources Corp	In Line	\$32.54	\$39.00
TRP	TC Energy Corp.	In Line	CAD71.83	CAD60.00
WMB	The Williams Companies Inc.	Outperform	\$19.04	\$28.00
WTRG	Essential Utilities Inc.	In Line	\$46.96	\$37.00

TIMESTAMP**(Article 3(1)e and Article 7 of MAR)**

Time of dissemination: February 27 2020 09:58

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Outperform- the total forecasted return is expected to be greater than the expected total return of the analyst's coverage universe

In Line- the total forecasted return is expected to be in line with the expected total return of the analyst's universe

Underperform- the total forecasted return is expected to be less than the expected total return of the analyst's universe

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*Prior to October 10, 2015, the "Coverage Suspended" and "Rating Suspended" categories were included in the category "Suspended."

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Prior to March 2, 2017, Evercore ISI's recommendations were based on a stock's total forecasted return over the next 12 months:

Buy- the total forecasted return is expected to be greater than 10%

Hold- the total forecasted return is expected to be greater than or equal to 0% and less than or equal to 10%

Sell- the total forecasted return is expected to be less than 0%

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Prior to October 10, 2014, the ratings system of ISI Group LLC and ISI UK which was based on a 12-month risk adjusted total return:

Strong Buy- Return > 20%

Buy- Return 10% to 20%

Neutral - Return 0% to 10%

Cautious- Return -10% to 0%

Sell- Return < -10%

For disclosure purposes, ISI Group and ISI UK ratings were viewed as follows: Strong Buy and Buy equate to Buy, Neutral equates to Hold, and Cautious and Sell equate to Sell.

Evercore Group:

Prior to October 10, 2014, the rating system of Evercore Group was based on a stock's expected total return relative to the analyst's coverage universe over the following 12 months. Stocks under coverage were divided into three categories:

Overweight- the stock is expected to outperform the average total return of the analyst's coverage universe over the next 12 months.

Equal-Weight- the stock is expected to perform in line with the average total return of the analyst's coverage universe over the next 12 months.

Underweight- the stock is expected to underperform the average total return of the analyst's coverage universe over the next 12 months.

Suspended- the company rating, target price and earnings estimates have been temporarily suspended.

For disclosure purposes, Evercore Group's prior "Overweight," "Equal-Weight" and "Underweight" ratings were viewed as "Buy," "Hold" and "Sell," respectively.

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Long- the stock is a positive holding in the model portfolio; the total forecasted return is expected to be greater than 0%.

Short- the stock is a negative holding in the model portfolio; the total forecasted return is expected to be less than 0%.

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Stocks included in the model portfolio will be weighted from 0 to 100% for Long and 0 to -100% for Short. A stock's weight in the portfolio reflects the analyst's degree of conviction in the stock's rating relative to other stocks in the portfolio. The model portfolio may also include a cash component. At any given time the aggregate weight of the stocks included in the portfolio and the cash component must equal 100%.

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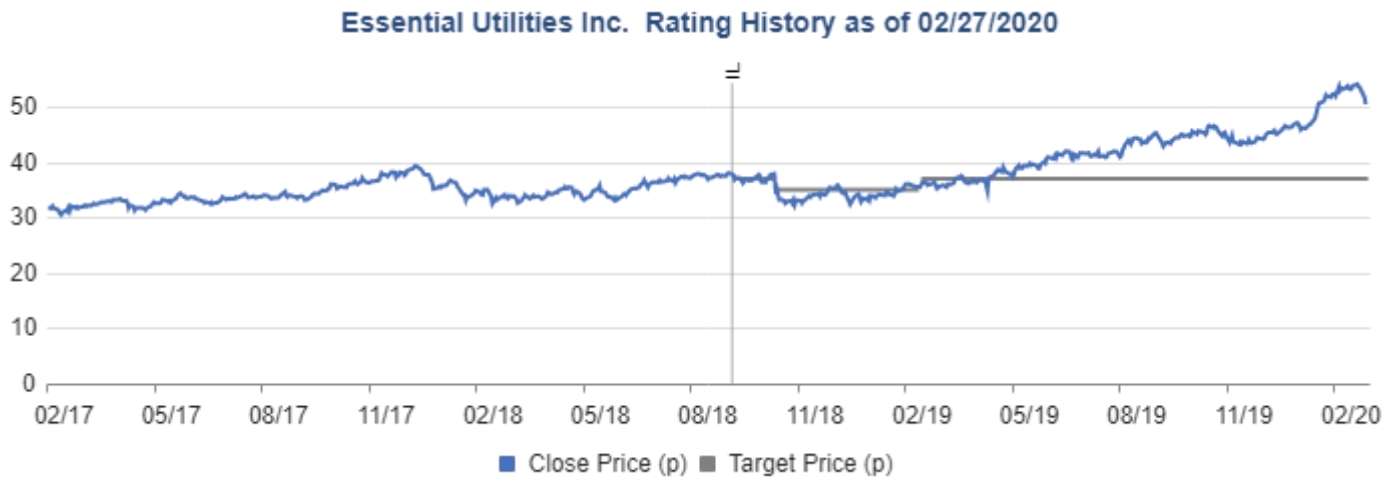
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Evercore ISI rating (as of 02/27/2020)

Coverage Universe			Investment Banking Services I Past 12 Months		
Ratings	Count	Pct.	Ratings	Count	Pct.
Buy	411	54	Buy	99	24
Hold	276	36	Hold	37	13
Sell	43	6	Sell	6	14
Coverage Suspended	23	3	Coverage Suspended	8	35
Rating Suspended	14	2	Rating Suspended	2	14

Issuer-Specific Disclosures (as of February 27, 2020)

Price Charts



Ratings Key					
B	Buy	OP	Outperform	L	Long
H	Hold	IL	In Line	NP	No Position
S	Sell	UP	Underperform	S	Short
				CS	Coverage Suspended
				RS	Rating Suspended

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